

Office of Chief Counsel  
Internal Revenue Service  
**Memorandum**

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(Small Business/Self-Employed)

from: Joseph W. Clark  
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subject: Continuous Levy on Single-Owner LLC

This Chief Counsel Advice responds to your April 28, 2008 request for assistance. This advice may not be used or cited as precedent.

ISSUES

1. Does a disregarded single-owner limited liability company (LLC) receiving fees from a county in connection with providing child daycare services to the county hold property or rights to property of the owner to which a levy can attach?

2. Whether a continuous levy (Form 668A) served upon a county will attach to payments made by the county to a disregarded single-owner LLC for child care services where the Service is attempting to collect the income tax liabilities of the LLC's owner?

3. Whether a continuous levy (Form 668A) served upon a county will attach to payments made by the county to a disregarded single-owner LLC (electing to be taxed as a corporation) for child care services where the Service is attempting to collect the income tax liabilities of the LLC's owner?

4. Whether the net profits the single owner receives from the LLC are subject to a continuing wage levy?

## CONCLUSIONS

1. The single owner's share of the net profits held by the LLC in connection with daycare services rendered by the owner may be levied upon to collect the owner's tax liabilities.
2. No. Under Ohio law an LLC is separate and distinct from its owners and the LLC's assets may not be used to satisfy a judgment or debt of an owner.
3. No, for the same reason as in #2 above.
4. [REDACTED], the LLC may be required to honor a continuous wage levy served upon it to reach payments being made to the single owner if such payments are in the nature of salary or wages.

## FACTS

You indicated that the field collection group in your area has encountered recurring issues regarding the collection of tax liabilities associated with single-owner LLCs. The following facts are based on an amalgam of approximately 6 cases and do not relate to any specific taxpayer. You have requested our assistance because this issue of whether the Service can levy to collect the tax liabilities of an LLC's owner from a disregarded LLC comes up often.

The amalgamated taxpayer is a single owner of an LLC that is organized under Chapter 1705 of the Ohio Revised Code.<sup>1</sup> The LLC provides daycare services to a county within the State of Ohio pursuant to a written contract. The county contracts with the LLC, rather than the entity's owner, for daycare services. The contract requires the daycare service provider to submit invoices for child daycare services rendered to the county within 30 days of the close of a designated billing period. The county pays the invoices within 30 days of receipt. You stated that the contract characterizes the LLC's owner as a self-employed independent contractor. In the scenario you developed, the only potential asset source available to satisfy the single owner's liability is the income received from the LLC under the contract with the county.<sup>2</sup>

For Federal income tax purposes, the LLC is disregarded and its activities are treated in the same manner as a sole proprietorship. The LLC's owner reports taxable income as net profits received from the operation of a business on Schedule C.

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<sup>1</sup> Ohio Rev. Code Ann. §§ 1705.01-1705.61 (2008).

<sup>2</sup> There is nothing in the facts that would support disregarding the LLC as an entity distinct from its owner under an alter ego or nominee theory. There is no evidence, for example, that the single owner uses the LLC to pay personal expenses.

The client has further asked if the Service would be successful in levying on the county in this situation if the LLC made an election to be taxed as a corporation for Federal tax purposes.

### LAW AND ANALYSIS

1. *Does the LLC hold property or rights to property of the LLC's single owner which may be seized by levy to satisfy the owner's tax liability?*

If an individual fails to meet his tax obligations after demand, a lien automatically arises on all of his property and rights to property. I.R.C. § 6321. This lien continues until the liability is satisfied or becomes unenforceable by reason of lapse of time. *Id.* at § 6322; U.S. v. Jefferson-Pilot Life Ins. Co., 49 F.3d 1020 (4<sup>th</sup> Cir. 1995). To enforce the lien, the Service can either bring a foreclosure action in court pursuant to section 7403 or it can levy on the taxpayer's property pursuant to section 6331. United States v. Hemmen, 51 F.3d 883 (9<sup>th</sup> Cir. 1995). Unlike a foreclosure action, the levy is a provisional, administrative procedure, National Bank of Commerce, 472 U.S. at 722, 105 S.Ct. at 2924, and it reaches only "property possessed and obligations existing at the time of the levy." Hemmen, 51 F.3d at 887 (*quoting* I.R.C. § 6331(b)). Treasury Reg. § 301.6331-1(a)(1) interprets this "present obligation" requirement as follows:

. . . Except as provided in § 301.6331-1(b)(1) with regard to a levy on salary or wages, *a levy extends only to property possessed and obligations which exist at the time of levy. Obligations exist when the liability of the obligor is fixed and determinable although the right to receive payment thereof may be deferred until a later date . . .* (emphasis added).

As a threshold matter, therefore, we must determine whether the single owner's right to receive income from the LLC is "property" or a "right to property" under Ohio law. Hemmen, 51 F.3d at 886; *see also* Drye v. United States, 528 U.S. 49, 52, 120 S.Ct. 474, 478 (1999)(court looks initially to state law to determine taxpayer's interests or rights and then to Federal law to determine whether those rights or interests constitute property or rights to property within section 6321). Under Ohio law personal property includes goods, chattels, choses in action, evidences of debt and money. Wireman v. Keneco Distributors, Inc., 1994 Ohio App. Lexis 2295 (1994); Cincinnati Street Ry. Co. v. Whitehead, 39 Ohio App. 51, 176 N.E. 583 (1930); 63C Am. Jur.2d at § 18.

The Ohio limited liability company statute defines a membership interest in an LLC to include a member's share of the profits and losses and the right to receive distributions. Ohio Rev. Code Ann. § 1705.01(H). Unless otherwise provided in the LLC's operating agreement, distributions are made to the members in proportion to the value of their contributions to the LLC which have not been returned. *Id.* at § 1705.11. The owner's right to share in the profits and losses of the LLC and to receive distributions is property under Ohio law. *Cf.* Cincinnati Street Ry., *supra*.

Next, we must consider whether, as a matter of federal law, a notice of levy served on the LLC will obligate it to turn over the income to which the LLC's owner is entitled to receive as a consequence of rendering daycare services to the county. Hemmen, *supra*. In order for the LLC to be obligated to turn over property or monies to the Service, it must be in possession of the single owner's property or be obligated to such person at the time of levy. Treas. Reg. § 301.6331-1(a)(1); Beam v. Internal Revenue Service, 1999 U.S.App. Lexis 25605 (9<sup>th</sup> Cir. 1999); Bank One Ohio Trust Company, N.A. v. United States, 80 F.3d 173 (6<sup>th</sup> Cir. 1996). Courts hold that the "fixed and determinable" requirement in Treas. Reg. § 301.6331-1(a)(1) is satisfied when the events which give rise to the obligation have occurred and the amount of the obligation is capable of being determined in the future. Hemmen, 51 F.3d at 890 (bankruptcy trustee's liability to pay the administrative expense claim to the taxpayer was fixed and determinable because the taxpayer fully performed the beneficial acts which gave rise to his claim prior to service of levy); CPS Electric, Ltd v. United States, 200 F.Supp.2d 120, 125 (N.D.N.Y. 2002) (cause of action in context of personal injury lawsuit, not its undetermined proceeds, was a property interest to which levy attached); United States v. Antonio, 1991 U.S. Dist. Lexis 14129 (D. Haw. 1991)(obligation on contract was fixed when performance occurred); United States v. Murray, 640 F.Supp. 89 (E.D. Tenn. 1986)(manufacturer's obligation to pay commission to taxpayer was fixed because the contractual work was fully performed as of levy date); *but see* Tull v. United States, 69 F.3d 394 (9<sup>th</sup> Cir. 1995)(auctioneer did not have a fixed and determinable obligation to the taxpayer even though there was a signed auction contract because both buyer and price were undetermined at time of levy).

In this case the Service can serve a notice of levy upon the LLC to require it to turn over income in its possession to which the single owner is entitled as a result of daycare services rendered prior to the service of the notice of levy.<sup>3</sup> Under the rationale of Hemmen, Murray, CPS Electric and other cases, the LLC's obligation to the single owner becomes "fixed and determinable" when the daycare services are rendered and after the LLC sets aside a reserve for overhead expenses.<sup>4</sup>

*2. Does the county hold the single owner's property or obligations owed to such owner?*

For purposes of the collection of Federal tax liabilities, the proper inquiry is to first determine the rights and interests of the taxpayer in the property under state law, and thereafter determine if such rights or interests are property or rights to property under the Code. Drye, 528 U.S. at 58, 120 S.Ct. at 475. If under the first prong of the Drye

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<sup>3</sup> While this is one alternative for collecting the tax liabilities, we recommend that you also consider developing additional facts and possibly serving a wage and salary levy on the LLC, as discussed below.

<sup>4</sup> If for any month the LLC's owner does not provide daycare services under the contract, the LLC will hold no net profits attributable to that particular month to which a levy could attach.

test the taxpayer has no interest or rights under state law, it follows that the owner has no property or rights to property under the Internal Revenue Code.

In the scenario presented, the present or future payments which may be made to the LLC under the contract are not fixed and determinable as to the single owner because the contract is between the LLC and the county, not between the LLC's owner and the county. This is consistent with the courts' interpretation of Treas. Reg. § 6331-1(a)(1), that the LLC, rather than the single owner, holds the right to receive payments from the county following the rendering of child daycare services. CPS Electric, supra. Ohio law provides that an LLC is separate and distinct from its owner, and a creditor may not use the LLC's assets to satisfy a debt of an individual owner. Firstmerit Bank NA v. Washington Square Ent. et al., 2007 Ohio App. Lexis 3561 (2007)(sole owner of LLC did not have a direct ownership in entity's assets and those assets could not be used to satisfy judgment against owner); Adler v. Nichols, 166 F.2d 674, 678 (10<sup>th</sup> Cir. 1948)(partnership checking account in bank not subject to distraint to satisfy liability assessed against individual partner). Consequently, whether the LLC is disregarded or elects to be taxed as a corporation for Federal tax purposes, a levy served upon the county will be ineffective to collect the tax liabilities of the single owner.<sup>5</sup> Under the Internal Revenue Code, however, the Service may either levy on the owner's membership interest in the LLC and sell it, or the Service may file suit to foreclose the federal tax lien against the ownership interest.

3. *Whether the net profits paid to the single owner by the LLC are subject to a continuing wage levy?*

As noted above, a levy generally extends only to property possessed and obligations existing at the time levy is made. An exception to this general rule, I.R.C. § 6331(e), authorizes a continuing levy upon salary or wages. Meehan v. Commissioner, 122 T.C. 396, 400 (2004). Section 6331(e) provides:

(e) Continuing levy on salary and wages

The effect of a levy on salary or wages payable to or received by a taxpayer shall be continuous from the date such levy is first made until such levy is released under section 6343.<sup>6</sup>

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<sup>5</sup> Under final regulations, published in the Federal Register August 16, 2007 (TD 9356, 72 F.R. 45891), unincorporated single-owner business entities will be regarded for purposes of employment and excise taxes. The excise tax amendments apply to liabilities imposed and actions first required or permitted in periods beginning January 1, 2008, and the employment tax provisions apply to wages paid on or after January 1, 2009.

<sup>6</sup> The regulation interpreting this provision describes the types of payments covered by this Code section as follows:

(1) *Continuing effect of levy on salary and wages.-*

. . . For this purpose, the term *salary or wages* includes compensation for services paid in the form of fees, commissions, bonuses, and similar items. The levy attaches to both salary

Section 6331(e) does not specify the types of remuneration that are covered by the terms “salary or wages.” Meehan, 122 T.C. at 401. But the courts have construed this to include a variety of types of payments. Sims v. United States, 359 U.S. 108, 79 S.Ct. 641 (1959)(compensation due to state and municipal employees); Meehan, 122 T.C. at 403-04 (severance pay paid by an employer to its former employee); In Re Anderson, 250 B.R. 707 (Bkrtcy. D. Mont. 2000)(social security payments); Maloney v. Syvertsen, 85-2 U.S.T.C. P9,578 (S.D.N.Y. 1985)(future wages and fees).

In U.S. v. Jefferson-Pilot, supra, the Fourth Circuit considered the Government’s action to enforce a continuous levy against an insurance company (“defendant”), which paid commissions to an independent contractor insurance salesman. The defendant argued that the Service only had the authority to serve it with a one-time levy because it was not the taxpayer’s employer.

The court in Jefferson- Pilot ruled for the Service, holding that: 1) the words “salary or wages payable to or received by a taxpayer “ in Code section 6331(e) are not so restrictive as to exclude the possibility that Congress intended them to apply to a commission paid to an independent contractor; 2) the underlying purpose of I.R.C. § 6331(e) is to provide a means of levying upon the remuneration payable to a taxpayer on a recurring basis for personal services for the payor; 3) the legislative history indicated that Congress created the continuing levy provision in order to ease the substantial administrative problems the Service would face if it could only impose successive levies upon remuneration contractually owed to a delinquent taxpayer for personal services. Jefferson Pilot, 49 F.3d at 1022-23; *see also* United States v. MPM Financial Group, Inc., 2005-2 U.S.T.C. P50,650 (E.D. Ky. 2005)(S corporation improperly failed to honor levy in connection with president’s proportionate share of income from commissions).

More recently, a district court held that the amounts paid and payable to a member of a law firm, organized as a partnership, were subject to a continuing levy. United States v. Moskowitz, Passman & Edelman, 2007 U.S. Dist. Lexis 75407 (S.D.N.Y. 2007). In Moskowitz, the delinquent taxpayer, an attorney, was a partner in a law firm. There, evidence developed through the deposition of the partner who handled the books of the firm showed that: 1) he wrote himself and his junior partner checks from whatever was available in the law firm’s bank accounts; 2) he wrote the checks on a weekly basis; 3) the checks were intended as rough advances to each partner against the total income

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or wages earned but not yet paid at the time of levy, advances on salary or wages made subsequent to the date of levy, and salary or wages earned and becoming payable subsequent to the date of the levy . . . In general, salaries or wages that are the subject of a continuing levy . . . are to be paid to the district director . . . on the same date the payor would otherwise pay over the money to the taxpayer . . .

and firm profits they were due to receive in a given year; and 4) the payments were principally motivated by one of the partner's "continuing needs".<sup>7</sup>

Relying on Jefferson-Pilot and United States v. Has, Inc., 1990 U.S. Dist Lexis 2473 (D. Puerto Rico 1990), the Moskowitz court rejected the taxpayer's argument that the payments he received from the firm were not subject to levy because they were draws or advances against what was ultimately converted to income at the end of the year. 2007 U.S. Dist Lexis 75407, at 5. In support of its holding, the court stated, ". . . [k]eeping in mind the spirit of the law, the fact that monies are paid out to the partners frequently [sic] weekly as advances on future income cannot exempt the law firm from the statute by virtue of . . . [the taxpayer's] partner status." *Id.* at 5-6. Accordingly, the periodic draws from the partnership paid to the partner constituted income or salary subject to the continuing levy. *Id.* at 6.

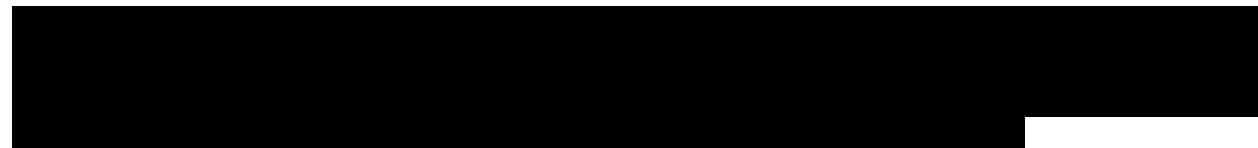
Based on Jefferson-Pilot and Moskowitz, the payments the single owner receives from the LLC as a share of the net profits *may* be subject to the continuing wage levy provision of I.R.C. § 6331(e). [REDACTED]

#### CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

Given the district court's holding in Moskowitz, *supra*, there is a possibility that the Service can characterize the profits the single owner receives from the LLC as income subject to a continuing wage or salary levy under I.R.C. § 6331(e). [REDACTED] in Moskowitz and Jefferson-Pilot, each court based its decision on the fact that the remuneration was paid out to the delinquent taxpayer on a recurring basis. Jefferson- Pilot, 49 F.3d at 1022 (legislative history of I.R.C. § 6331(e) indicates that underlying purpose to provide a means of levying upon remuneration payable to a taxpayer on a regular basis). In Moskowitz, *supra*, the managing partner in the law firm wrote checks to himself and his other partner weekly.

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<sup>7</sup> A continuous levy served on the law firm stated that it applied to "This taxpayer's wages and salary that have been earned but not paid yet, as well as wages and salary earned in the future until this levy is released." A second levy a required the firm to turn over "this taxpayer's other income that you have now or for which you are obligated." 2007 U.S. Dist. Lexis 75407, at 1-2.



If a court rules against the Service on the question of whether the LLC must honor a continuous wage levy, then the Service will have to argue that its levy attaches to the property of or obligations owed to the single owner at the time of levy. In this instance, the Service will have to serve successive levies upon the LLC, under authority of I.R.C. § 6331(c) until the single owner's tax liabilities are satisfied. In Re Metropolitan Metals, Inc., 217 B.R. 457 (M.D. Pa. 1997).

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